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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 957

WILLIAM J. DEMOREST, JR., ANN DEMOREST AND CAROLYN DEMOREST, BY GERALD P. CULKIN, THEIR SPECIAL GUARDIAN,

Appellants,

vs.

CITY BANK FARMERS TRUST COMPANY, AS TRUSTEE UNDER THE WILL OF HENRY C. WEST, DECEASED, ET AL.

APPEAL FROM THE SURROGATE'S COURT OF NEW YORK COUNTY, STATE OF NEW YORK.

STATEMENT AS TO JURISDICTION.

GERALD P. CULKIN,
Counsel for Appellants.

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COURT OF APPEALS OF THE STATE OF NEW YORK

In the Matter of the Judicial Settlement of the Account of Proceedings of CITY BANK FARMERS TRUST COMPANY as Trustee of the trusts created under the Last Will and Testament of HENRY C. WEST, Deceased, and of the Application of CITY BANK FARMERS TRUST COMPANY as Trustee as aforesaid, for a Determination as to the Construction and Effect of said testator's Last Will and Testament, and for Instructions and Directions as to the Manner and Method of Allocation and Distribution of the Funds which are now or may hereafter be in its hands as Trustee as aforesaid.

WILLIAM J. DEMOREST, JR., ANN DEMOREST AND CAROLYN DEMOREST,

Infant Appellants,

EMMA M. WEST,

Appellant,

CITY BANK FARMERS TRUST COMPANY, AS TRUSTEE, ETC.

Respondent,

MARIE ELIZABETH WEST-JONES AND ELIZABETH FRANCES JONES,

Respondents.

JURISDICTIONAL STATEMENT PURSUANT TO SUPREME COURT RULE 12.

Comes now William J. Demorest, Jr., Ann Demorest and Carolyn Demorest, by their special guardian, Gerald P. Culkin, the appellants herein, and file the following state-

ment as required by Rule 12 of the Supreme Court of the United States.

1. Basis Upon Which It Is Contended That the Supreme Court of the United States Has Jurisdiction.

The judgment appealed from is the final judgment of the Court of Appeals of the State of New York, the highest court in the State of New York in which a decision herein could be had, and there is drawn in question in this suit the validity of a statute of the State of New York on the ground of its being repugnant to the Constitution of the United States and the said decision of said Court of Appeals is in favor of the validity of said statute.

2. Statutory Provision Believed to Sustain Jurisdiction.

The statutory provision which sustains the appellate jurisdiction herein of the Supreme Court of the United States is Section 237(a) of the Judicial Code, as amended by the Act of February 13, 1925, Chapter 229, 43 Stat. 936 [28 U. S. C. A. Sect. 344(a)]; also the Act of January 31, 1928, Chapter 14, Section 1, 45 Stat. 54 and the Act of April 26, 1928, Chapter 440, 45 Stat. 466 [28 U. S. C. A. Sect. 861a, 861b].

3. The Statute of the State, the Validity of Which Is Involved.

The statute of the State of New York herein involved is subdivision 2 of Section 17-c of the Personal Property Law of the State of New York which is a part of Chapter 452 of the Laws of New York 1940, p. 1182. Said statute became a law on April 13, 1940, with the approval of the Governor of the State of New York. Subdivision 2 thereof provides as follows:

> "2. The existing rules of procedure applying to salvage operations respecting existing mortgage invest-

ments are continued except as modified by the subparagraphs hereinafter set forth. The terms and rules of procedure of this subdivision shall apply specifically (a) to the estates of persons dying before its enactment and (b) to mortgages on real property held by a trustee under a deed of trust or other instrument executed before the date of its enactment and (c) to real property acquired by foreclosure of mortgage or real property acquired in lieu of foreclosure before or after the date of its enactment in trusts created or mortgage investments made prior thereto, and (d) to any pending proceeding or action for an accounting of the transactions of an executor or trustee.

(a) Net income during the salvage operation up to three per centum per annum upon the principal amount of the mortgage shall be paid to the life tenant, regardless of principal advances for the expenses of foreclosure or of conveyance in lieu of foreclosure and arrears of taxes and other liens which occurred prior to such foreclosure or conveyance and the cost of all capital improvements. Any payment of net income heretofore or hereafter made to the life tenant up to such three per centum per annum shall be final and shall be not subject to recoupment from the life tenant or as a surcharge against the trustee or executor. The amount of all such payments shall be taken into account, however, in the apportionment of the proceeds of sale and shall be charged against the share of the life tenant.

(b) The foregoing principal advances shall be repaid out of excess net income above such three per centum per annum. When principal advances have been satisfied, any excess income shall be impounded (subject to reinvestment under the terms of the will or deed) to await sale and apportionment.

(c) The unpaid principal advances shall be a primary lien upon the proceeds of sale and shall be paid first out of any cash so derived. If insufficient the balance shall be a primary lien upon any purchase money mortgage received upon the sale.

(d) The purpose of the enactment of this subdivision is declared to be the simplification of the rules of procedure in mortgage salvage operations and the elimination of present complications which work to the disadvantage of the life tenant, who is usually the principal object of the testator's or settlor's bounty, by depriving him of a fixed right to the actual payment of any net income earned by the property. Such fixed right is granted in lieu of the discretion now given to the trustee to pay net income or any part thereof to the life tenant. The general rules of the apportionment of the proceeds of sale between life tenant and remainderman are retained subject to the express modifications made herein. Only equitable adjustments and balances as between the parties are intended to be effectuated by the provisions of this subdivision. If any provision of this subdivision or the application thereof to any mortgage or acquired property by foreclosure or conveyance, or to any trust is held invalid, the remainder of the subdivision and the application of such provision to any other mortgage or property acquired by foreclosure or conveyance or other trust shall not be affected thereby."

4. Date of Judgment and Application for Appeal.

The date of the judgment of the Court of Appeals of New York sought to be reviewed herein is January 15, 1942, and the same was entered pursuant to the provisions of the law of New York in the Surrogate's Court, New York County, State of New York, on the 25th day of January, 1943. The date upon which the application for appeal is presented is April 3rd, 1943.

5. The Nature of the Case and of the Rulings of the State Court Which Bring the Case Within the Jurisdictional Provisions Relied On.

This proceeding was instituted in the Surrogate's Court of New York County, State of New York, by City Bank

Farmers Trust Company, as trustee under the last will and testament of Henry C. West, deceased, who died on the 1st day of May, 1934, a resident of said county. In said proceeding the said trustee prayed for a judicial settlement of the account of its proceedings as trustee down to the 31st day of July, 1940, and for instructions and directions with respect to its administration of said trust after said date. A respondent in said proceeding, Emma M. West, was the life beneficiary of the trust created under said last will and testament and your appellants are remaindermen thereof. The principal of said trust estate was in large part composed of bonds and mortgages owned by decedent at the date of his death.

Prior to April 13, 1940, some of said mortgages were foreclosed by the trustee and the real property covered thereby acquired by the trustee upon foreclosure sales, and in other instances deeds in lieu of such foreclosure were accepted by the trustee.

On April 13, 1940, the Governor of the State of New York approved Chapter 452 of the Laws of New York, 1940, which became Section 17-c of the Personal Property Law of the State of New York, which statute changed and modified the rules theretofore existing in the State of New York with respect to payment to life beneficiaries of rents received from real property acquired in salvage of mortgage investements held by trustees, by directing that out of any net rents received from such a parcel in any year there should be paid to the life beneficiary, without any right of recoupment, an amount equal to 3% of the face amount of the mortgage covering the property so acquired.

The account of proceedings of said trustee was prepared and submitted upon the basis that subdivision 2 of section 17-c of the Personal Property Law of the State of New York applied to the transactions of said trustee prior to April 13, 1940, and by its petition the said trustee requested

that it be instructed as to whether said statute should govern its future administration of said trust estate.

Your appellants, by the report and objections to said account filed by their special guardian, took the position that said statute could not be applied to the account of proceedings so filed or to the future administration of said trust without depriving them of their property without due process of law contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States.

The objections of your appellants were overruled by the decree of the Surrogate's Court and the trustee was directed to administer said trust on the basis that said statute was applicable to its actions subsequent to the date of said account. The decree of the Surrogate's Court was affirmed by order of the Appellate Division of the Supreme Court in and for the First Judicial Department of the State of New York to which an appeal was taken, and on further appeal to the Court of Appeals of the State of New York the order of the Appellate Division was affirmed. The final judgment of the Court of Appeals is, therefore, in favor of the validity of the state statute, against the contention of your appellants that said statute was invalid as repugnant to the Federal Constitution.

6. Cases Believed to Sustain Jurisdiction.

Senn v. *Tile Layers Union*, 301 U. S. 468, 476-7. There as here a state statute was involved, and the issue presented as to whether it violated the Fourteenth Amendment, which issue had never been passed upon by the United States Supreme Court. A motion to dismiss the appeal was denied.

7. State of Proceedings in State Courts and Manner in Which Federal Questions Sought to Be Reviewed Were Raised.

The account of proceedings of the trustee filed in the Surrogate's Court, New York County, State of New York,

was prepared on the basis that subdivision 2 of Section 17-c of the Personal Property Law applied to the allocation and apportionment of rents received from real property prior to the date of the enactment of such statute on April 13, 1940, and in its petition the trustee prayed for the judicial settlement of said account and requested instructions as to the manner in which moneys received by way of rents or proceeds of sale of real property acquired upon foreclosure of mortgage or by deed in lieu of foreclosure should be apportioned between principal and income of said trust estate subsequent to the closing date of said account (Record on Appeal—Petition: pp. 58-9, 61-2, fols. 174-7, 183-6; Account: 64-133, particularly income schedule p. 77, fols. 230-1, and recapitulations pp. 87-8, 92-3, 97-8, 102-3, 107-8, 113-14, 118-19).

At the first opportunity to do so your appellants, by the report and objections of their special guardian, raised the issue as to the unconstitutionality of subdivision 2 of Section 17-c of the Personal Property Law and asserted that it was repugnant to the Fourteenth Amendment to the Constitution of the United States, (Record on Appeal, p. 136, fol. 407, p. 139, fols. 416-17), objected to the allocation of income made on the basis of annual rents without regard to whether any net income had been derived from the property during the period of its operation on the ground that such method of computing annual income was unconstitutional (Record on Appeal, p. 136, fols. 407-8), objected to the items in which rents from said properties were credited to income (objections Numbered I and II, Record on Appeal, pp. 136-140, fols. 408-418). In support of said Objections it was stated (p. 139, fols. 416, 417):

> "* * * said statute is invalid and unconstitutional and its provisions arbitrary and said statute deprives my wards as residuary remaindermen of the trust estate of property without due process of law and in a manner prohibited by and contrary to the provisions of

• • • of the 14th Amendment to the Constitution of the United States of America."

The decree of the Surrogate's Court in this proceeding overruled said objections numbered I and II of the special guardian for your appellants (Record on Appeal, p. 19, fol. 55), judicially settled and allowed the account of proceedings of said trustee as filed with adjustments not here material (Record on Appeal, pp. 29-30, 32; fols. 87-8, 95-6) and gave extensive instructions to said trustee as to the manner of keeping its accounts and allocating as between principal and income the proceeds of sale and rents which might be received after the closing date of said account from property acquired by it upon foreclosure of mortgages held by it as such trustee or by deed in lieu of foreclosure thereof (said mortgages having been acquired prior to the date of the enactment of said statute), on the basis that subdivision 2 of Section 17-c applied to govern said trust and was constitutional in such application (Record on Appeal, pp. 32-43, fols. 96-127).

An appeal was taken to the Appellate Division of the Supreme Court of the State of New York held in and for the First Judicial Department by your appellants from each and every portion of the decree with certain exceptions not here material (Record on Appeal, pp. 4-5, fols. 12-14). Said Appellate Division of the Supreme Court by its order dated April 2, 1942, as resettled on April 16, 1942, unanimously affirmed said decree (Record on Appeal, p. 248, fol. 744).

Thereafter, the appellants appealed to the Court of Appeals of the State of New York from said order of said Appellate Division "in so far as it sustains the constitutionality of Section 17-c, subdivision 2, of the Personal Property Law of the State of New York" (Record on Appeal, p. 236, fol. 706). Thereafter, and on the 15th day

of January, 1943, the Court of Appeals handed down its opinion, two judges dissenting, sustaining in all respects the constitutionality of said statute and affirming said order of said Appellate Division, and by its order dated said day and entered on the 25th day of January, 1943, in the Surrogate's Court, New York County, said order of said Appellate Division was affirmed (remittitur annexed to Record on Appeal).

8. Opinions of the State Courts Necessary to Ascertain the Grounds of the Decree of the Surrogate's Court, the Order of the Appellate Division and Judgment of the Court of Appeals.

The following opinions which may be necessary to ascertain the grounds of the decree of the Surrogate's Court, the order of the Appellate Division and judgment of the Court of Appeals are hereto annexed and marked as indicated:

A. The opinion of Surrogate Foley, dated March 8, 1941, reported in 175 N. Y. Misc. Rep., at p. 1044.

B. The opinion of the Court of Appeals of the State of New York by Judge Finch, with dissenting opinions of Judges Loughran and Lewis reported in 289 N. Y. Advance Reports, p. 423.

Said Appellate Division rendered no opinion in unanimously affirming the decree of the Surrogate's Court.

9. Grounds Upon Which It Is Contended That the Federal Questions Involved Are Substantial.

That the questions here involved are substantial is perhaps best indicated by the fact that, subsequent to the decision in the instant case by the Surrogate of the County of New York, the other Surrogate of said County, in *Matter of Wacht*, 32 N. Y. Supp. (2d) 871 (not officially reported) condemned the statute in question as invalid, and two of the

judges of the Court of Appeals of the State of New York wrote separate dissenting opinions in which they similarly expressed the view that the statute was unconstitutional.

Your appellants contend that prior to the enactment of Section 17-c of the Personal Property Law of the State of New York, the law of that State with respect to the distribution as between principal and income of rents and the proceeds of sale of real property, acquired by a trustee on the foreclosure of a mortgage, had been established by the courts of that State, and that the law with respect thereto was a law of property.

They further contend that said statute deprives them of their property without due process of law, in that it directs the trustee to pay to the life beneficiary of the trust established by the will of Henry C. West rents from parcels of real property resulting from mortgage investments, which, under the law as enacted by that statute constituted principal of the trust which was payable to the remaindermen of said trust who are represented by your appellants. In this connection, they point out that the trust involved herein was established prior to the enactment of the statute. The mortgages in question were acquired by the trustee prior to the enactment of the statute. The real property was acquired on foreclosure or by deed in lieu of foreclosure prior to the enactment of the statute, and some of the rents received from such parcels of real property affected by the provisions of the statute were received prior to its enactment.

Under the law as it had been established by the courts of New York prior to the enactment of Section 17-c of the Personal Property Law, property acquired in salvage of a mortgage investment held by a trustee was deemed to be held by the trustee upon a trust for the sale thereof. Expenses of the foreclosure and in discharging tax liens and other charges against the property, accrued to the date of

closure, were to be temporarily advanced by the princi-
of the trust in which such mortgage was held. Likewise,
cits which might be incurred in the operation of the
perty after foreclosure were to be advanced from prin-
l. All sums advanced out of the principal of the trust
which the mortgage was held in connection with such
age operation were regarded as in the nature of a first
or charge against the property. Subject possibly to a
retionary power in the trustee to distribute as income
e of net rents, such rents were to be applied first toward
aying principal advances. After such principal ad-
ces had been repaid, then net rents might be paid over by
trustee to the life beneficiary as income, provided the
unt of such rents did not exceed the amount which might
found due to the life beneficiary upon the completion of
salvage operation. Upon the sale of the real property,
proceeds of sale were to be applied as follows:
Any principal advances which had not been repaid out of
ts were first to be discharged. The balance of the pro-
ds, plus any net rents from the property which had not
n used to discharge principal advances, were to be equi-
ly apportioned between the principal and income of the
st, in the ratio which the principal of the mortgage bore
he amount of the interest from the date of default, which
uld have been earned on the mortgage had it not been
eclosed. From the amount apportionable to income,
re was deductible any net rents theretofore credited to
ome (*Meldon* v. *Devlin*, 31 App. Div. 146, 158, aff'd 167
Y. 573; *Matter of Chapal*, 269 N. Y. 464; *Matter of Otis*,
N. Y. 101, reargument denied 277 N. Y. 650). There
s some indication in the reported cases to the effect that
trustee had some discretion to effect a distribution, as
ome, of some of the rents received from such a parcel of
l property. However, it appears that if the trustee paid
beneficiary more than the amount, which on completion

of the salvage operation was found to be apportionable to income, the trustee was liable therefor (*Matter of Brainerd*, 169 N. Y. Misc. 640).

The statute attempted to modify these rules. It provided that, if in any year the trustee receives net rents, it should pay therefrom to the life tenant up to three per centum of the principal amount of the mortgage. Such payments were required regardless of whether moneys advanced out of the principal of the trust to pay for the expenses of the foreclosure, arrearage of taxes, or other capital improvements had been repaid. The rule that the first duty of the trustee was to repay those principal advances out of any moneys received, whether by way of rents or sale of the real property, was abolished.

As construed by the New York courts, the statute requires that net rents received in any year should be so applied, although in all previous years the property may have been operated at a deficit, so that for the whole period from the date the property was acquired by the trustee to the end of the year, no net rents would have been received by the trustee. Nevertheless, the statute would require the trustee to treat net rents received in such a subsequent year as a separate unit, and disregard the losses incurred in earlier years.

Moreover, the statute provides that the payments made to the life beneficiary as directed by the statute shall be final, and shall not be subject to recoupment from the life tenant, and further, that the trustee shall not be liable for surcharge for having distributed rents to the life beneficiary, as directed by the statute.

The demand of the statute is inexorable and leaves no discretion on the part of the trustee. Although the property is subsequently sold for a sum which is not sufficient in amount to repay the principal advances to provide for the expenses of the salvage operation, nevertheless, under

the terms of the statute the life beneficiary is entitled to retain as income the rents received and which became distributable to the life beneficiary under the provisions of the statute.

Thus it will be seen that, in effect, the statute directs that moneys which, under the law as established prior to the enactment thereof, constituted part of the principal of the trust created by the will of Henry C. West, and which, upon the termination of the trust would be distributable to the remaindermen who are represented by your appellants, should be paid over and distributed as income to the life beneficiary of said trust. In other words, the principal of your appellants is, by the statute required to be paid to the life beneficiary, and your appellants are thus deprived of their property without due process of law and in violation of the rights guaranteed to them by the Fourteenth Amendment.

Moreover, due process of law requires that the equitable interests of the life beneficiaries and remaindermen in existing trusts shall be determined only by the courts. Enactments attempting to affect such existing rights are without the power of the Legislature and, it is submitted, invalid under the Fourteenth Amendment to the Constitution of the United States.

Dated April 3rd, 1943.

GERALD P. CULKIN,
Special Guardian for William J. Demorest, Jr., Ann Demorest and Carolyn Demorest.

APPENDIX A.

Opinion of Surrogate James A. Foley of New York County.

In the Matter of the Estate of Henry C. West, deceased.

175 Misc. 1042.

"FOLEY, S. In this accounting proceeding the answers of certain of the parties and the report of the special guardian have raised numerous issues involving salvage operations of mortgaged properties acquired by a trustee by foreclosure or by deed in lieu of foreclosure. Such issues involve in part questions as to the effect of the decisions of the Court of Appeals in Matter of Chapal (269 N. Y. 464) and Matter of Otis (276 id. 101), and in part the effect of the recently enacted section 17-c of the Personal Property Law, which modified in certain phases the former rules in salvage operations. The briefs of the various attorneys have analyzed these questions with commendable thoroughness.

Under the terms of the testator's will, the residuary estate was devised and bequeathed in trust, 'to apply the net income from said estate to the use of my wife, Emma M. West, during the term of her natural life, or until she shall remarry.' Upon the death of the testator's widow, the estate was directed to be continued to be held in trust upon certain shares for the benefit of a nephew and a niece of the testator, with contingent remainders. The trust is still in effect.

At the date of his death the testator owned a number of entire guaranteed mortgages. Title to nine of the properties, upon which the mortgages were liens, was acquired by the executor either by foreclosure sale or by deed in lieu of foreclosure. By the decree of this court, dated August 10, 1936, upon an accounting by the executor, the properties so acquired were directed to be transferred by the executor to itself as trustee, as assets of the trust, to be held in separate account by the trustee. Questions as to the apportionment of the proceeds received upon the ultimate sale of the properties and the respective rights of principal and income beneficiaries in them were reserved for determination by decree in a subsequent accounting proceeding of the trustee.

The trustee has now accounted for the operation of each of these properties. The account discloses that as to seven of the properties the salvage operations are still unfinished. The operation of the other two properties is complete, since they were resold prior to the enactment of section 17-c of the Personal Property Law—one for cash and the other for part cash and part by the execution and delivery of a purchase-money mortgage. No distribution, however, has been made of the proceeds of sale of either of these properties.

The issues raised may be summarized as follows:

First. The constitutionality of subdivision 2 of section 17-c of the Personal Property Law (added by Laws of 1940, chap. 452, effective April 13, 1940) which modified, in certain respects, the prior rules in mortgage salvage operations.

Second. If constitutionality be sustained, the effect of the terms of that subdivision upon salvage operations falling within its scope.

Third. The determination of new questions not arising under section 17-c of the Personal Property Law and not decided specifically by the Court of Appeals in Matter of Chapal (supra) and Matter of Otis (supra) or by other authorities dealing with mortgage salvage operations.

First. In the consideration of the constitutionality of new section 17-c of the Personal Property Law, the prior decisions of the Court of Appeals, the existing situation in trusts, the reasons and conditions which led to its enactment and the terms of the section itself become important. The Chapal-Otis rules had, to a great extent, simplified the problem of the trustee, the lawyer and the courts of first instance, in dealing with particular situations developed before them. But complications still remained in salvage operations.

As the economic depression subsequent to 1929 deepened and the value of real properties melted, a waive of foreclosures resulted. Mortgages, which had been regarded in former years as attractive and desirable investments for trust funds, created after foreclosure or acquisition of title complicated and difficult questions with the imposition of

burdensome expense to persons interested in trust estates. The complications involved in the computation in a pending or completed salvage operation are emphasized in the pending proceeding where the mathematical analyses and the supporting schedules cover fifty-one closely typed pages of the account. The solution of these problems became the subject of study by members of the bar and particularly by those who were specialists in the law of trusts and estates. In liaison with the executive committee of the Surrogates' Association of our State, intensive investigation was made with the objective of simplification of the rules applying to mortgage salvage operations. Two solutions were immediately presented. The first involved a repeal of the Chapal-Otis rules in their entirety, with a recommendation to the Legislature to enact a statute which would treat the foreclosed or acquired real property as a capital asset in the same manner as ordinary real estate left by a testator. If the foreclosed real estate was thus treated as a capital asset, net income derived from the property would become immediately payable to the life tenant. Upon a sale of the realty, the proceeds would be treated as part of principal. Upon such sale, no allocation between life tenant and remainderman was required. Such was the form of the statutory relief passed by the Legislature of Connecticut. (Pub. Acts (1939), chap. 232.)* The obstacle to the recommendation of the passage of such a sweeping statute, despite the common sense approach which motivated it, was the belief by some of the conferees that if it were applied to mortgage investments made before the effective date of the new statute, it might be subject to the hazards of a determination of unconstitutionality. The second alternative of those who drafted and recommended the passage of the statute by the Legislature was to divide the problem into two parts. The division provided, first, for the abolition of salvage operations as to future investments in mortgages and, second, with the major objective of assisting life tenants, for the modification, within constitutional limits, of the existing law as to investments in mortgages made prior to the effective date of the statutory amendment. That program was ultimately adopted and is embodied in new section 17-c of the Personal Property Law.

Its first subdivision abolished the Chapal-Otis rules as to testamentary trusts of persons dying after the effective date of the statute and as to inter vivos trusts thereafter established. It likewise was made to apply to mortgage investments made after such effective date in existing trusts, whether testamentary or inter vivos. As to such trusts and mortgaged real property the new subdivision stated that the 'real property shall be and become a principal asset in lieu of' the mortgage. The 'tenant or tenants for life or limited term shall be entitled to the net income from such acquired real property from the date of its acquisition.' The rules of procedure under the Chapal-Otis decisions were 'abolished'. Any allocation or apportionment between life tenant and remainderman was prohibited. In the pending proceeding no question has arisen as to the constitutionality of such first subdivision. Indeed no such question would be tenable since its provisions were wholly prospective in operation.

We now come to the consideration of the terms of the second subdivision of the section, the constitutionality of which is in dispute here. Two relatively simple modifications of the Chapal-Otis rules were made in this subdivision. Under those rules and particularly under the language of the opinion of Judge Loughran in Matter of Otis (supra), a discretionary power was given to a trustee during a mortgage salvage operation to disburse income to the life tenant, after advances made from principal as an incident to the acquisition of the property had been repaid. It was found, however, that trustees hesitated to make any payment to the life tenant or to exercise the judicial discretion given to them by Matter of Otis, because of the fear of a possible surcharge in the event of an overpayment to the life tenant. The life tenant in almost every instance was the primary object of the testator's bounty. The beneficiary intended to be most favored was thus deprived, by the trustee's inaction or hesitancy, of receiving income during the entire salvage period and large sums of money were accumulated and frozen. The injustice to the life tenant was aggravated by the fact that because of the lack of a ready market for the resale of the property, the salvage operation was unduly

extended for a long period of years. This situation is emphasized by the facts revealed in the present proceeding. Of the seven mortgages now involved in the salvage operations in which no resale has taken place, the longest period of operation has been six years and two months. The shortest period has been four years and ten months. Thus the average period of operation of all seven mortgages has been approximately five years. .In the two completed operations the periods of salvage were two years and six months and two years and eight months. This unhappy situation has been corrected by the new legislation. Trustees are expressly authorized to pay promptly net income derived from the foreclosed or acquired property up to three per centum per annum upon the face amount of the mortgage. From the time of the passage of the new act, it has been the practical experience and observation of the surrogates that hundreds of thousands of dollars which had been theretofore accumulated, were paid out to life tenants upon the authority granted by the statute. Where the trustee had paid the yearly income up to the three per cent maximum to the life tenant, the statute made the payment final. It was specifically stated by the Legislature that such payment up to the maximum was 'not subject to recoupment from the life tenant or as a surcharge against the trustee or executor.' Moreover, under the new statutory rule, net income up to the maximum of three per cent became payable from the very beginning of the salvage operation, that is, from the date of acquisition by foreclosure or by deed in lieu of foreclosure.

The other amendment to the Chapal-Otis rules made by the second subdivision of the new section in the balancing of the equities, furnished protection to the remaindermen interested in the principal of the trust. Excess net income earned in any one year during the salvage operation above the three per cent maximum payable to the life tenant, was directed to be applied to advancements from principal for arrears of taxes and other liens which accrued prior to the foreclosure or acquisition in lieu of foreclosure and to the cost of capital improvements. Where any balance of unpaid principal advances remained due at the close of the

salvage operation, such balance was declared to be 'a primary lien upon the proceeds of sale and shall be paid first out of any cash so derived. If insufficient the balance shall be a primary lien upon any purchase money mortgage received upon the sale.'

The special guardian of the infant remaindermen has, perhaps, by way of formal objection with a view to a review of this decision by the appellate courts, raised the issue of unconstitutionality. By that procedure it is hoped by all those interested in this program of law reform, that the constitutionality of the new statute will be forever quieted. In essence, therefore, this proceeding is to be regarded as a test case. The special guardian contends that the new statute deprives his wards of property rights and that it is violative of the due process clause of the Fourteenth Amendment of the Federal Constitution and of the similar clause contained in our State Constitution.

His specific attack is based upon the retroactive provisions of the new second subdivision which apply to mortgage investments made previous to its enactment or to salvage operations initiated prior to such enactment. It provides: 'The terms and rules of procedure of this subdivision shall apply specifically (a) to the estates of persons dying before its enactment, and (b) to mortgages on real property held by a trustee under a deed of trust or other instrument executed before the date of its enactment, and (c) to real property acquired in lieu of foreclosure before or after the date of its enactment in trusts created or mortgage investments made prior thereto, and (d) to any pending proceeding or action for an accounting of the transactions of an executor or trustee.' It is claimed that the effect of that subdivision was to take away property from the remainderman in so far as the amounts paid to the life tenant up to the maximum of three per cent per annum might exceed the income allocable to him under the Chapal-Otis rules at the close of the mortgage salvage operations.

All of these contentions are overruled. The provisions of the new subdivision are merely remedial, procedural and administrative. The Legislature has done no more in

formulating a modification of existing rules than the courts themselves could do and have done within their constitutional powers. 'In a general sense the rules as to these salvage operations have been in a fluid state and have never been absolutely or finally fixed by the courts in their application to existing trusts or prior salvage operations. The strongest support for that conclusion is found in the opinion of Judge Loughran in Matter of Otis (supra). He there stated, 'Perhaps it should be added that a general rule for such situations cannot be attained at a bound, that no rule can be final for all cases and that any rule must in the end be shaped by considerations of business policy. Accordingly, we have here put aside inadequate legal analogies in the endeavor to express fair, convenient, practical guides that will be largely automatic in their application. Only the sure result of time will tell how far we have succeeded.' (Matter of Otis, supra, p. 115.) The 'sure result of time' had led the Legislature to make the changes of procedure upon the ground of necessity and advisability by the enactment of the new subdivision. The traditional tests of a statute are the old law, the mischief and the remedy. It is the duty of the courts so to construe the act as to suppress the mischief and advance the remedy. The legislative purpose was declared in the statute itself in subparagraph (d) of subdivision 2 of the section. It reads: 'The purpose of the enactment of this subdivision is declared to be the simplification of the rules of procedure in mortgage salvage operations and the elimination of present complications which would be to the disadvantage of the life tenant, who is usually the principal object of the testator's or settlor's bounty, by depriving him of a fixed right to the actual payment of any net income earned by the property. Such fixed right is granted in lieu of the discretion now given to the trustee to pay net income or any part thereof to the life tenant. The general rules of the apportionment of the proceeds of sale between life tenant and remainderman are retained subject to the express modifications made herein. Only equitable adjustments and balances as between the parties are intended to be effectuated by the provisions of this subdivision.'

The additional reasons which moved the Legislature to modify the existing rules under the Chapal-Otis decisions are stated in the explanatory note which was printed in the legislative bill. It is indicative of the intent of the Legislature. It reads in part: 'The Chapal-Otis rule authorizes the trustee to pay surplus net income in his discretion. Trustees have hesitated to pay such net income because in the case of overpayment to the life tenant, the trustee might be surcharged with that amount. The life tenant of the trust must wait in the majority of cases for a long period of time before he becomes entitled to the payment of any income, because of the present requirement that advances from principal for the expenses of foreclosure and for arrears of taxes and other liens must first be paid from the net income of the property. The amendment provides for the immediate payment of income to the life tenant beginning with the date of the acquisition of the property by the trustee by foreclosure or conveyance in lieu of foreclosure.'

Again, the nature of a salvage operation was described in Matter of Otis (supra), as a resort to fictions. 'Both capital account and income account, as described in the Chapal case, are fictions. * * * If, then, the remaindermen are to participate in the apportionment on the feigned basis of unimpaired principal, the share of the life tenant should be computed on the same assumption. The invention of the 'original investment' is no more valid than the invention of 'unpaid interest' thereon. Indulgence in both fictions keeps the balance even between the respective parties in interest.' Under the 'historic fictions' of the English law and the modern fictions which exist under our own law, their ineptness have led to change and improvement by the courts which had to apply them. This very ineptness also constituted an invitation to Parliament in England, and to our own Congress and Legislatures, to alter the fictions, particularly in procedural matters, in order to correct injustice. Fictions, as stated by Professor Gray, were invented and altered 'in order that the wine of new law might be put into the bottles of ole procedure.' (Gray, The Nature and Sources of the Law, p. 34.) The fiction was always capable of modification to meet the needs of modern justice.

Alterations of rules of procedure or administration made by the Legislature or by the courts, do not change substantive rights. Rules of procedure may, therefore, be modified, added to or repealed as the exigencies of the law and particular situations require. 'Nor has a person a vested interest in any rule of law entitling him to have the rule remain unaltered.' (Preston Co. *v.* Funkhouser, 261 N. Y. 140; affd., sub nom. Funkhouser *v.* J. B. Preston Co., 290 U. S. 163, citing Truax *v.* Corrigan, 257 id. 312, 348.)

It is claimed that the effect of subdivision 2 of section 17-c was to take away property from the remainderman, in so far as the amount ultimately payable to him on a sale of the real property might be less than the amount which would be payable to him under the rules laid down in Matter of Chapal (supra) and Matter of Otis (supra). The possibility that such a situation might result is infinitesimal. Two factors show the extreme improbability of the occurrence of such an event. The customary mortgage interest rate for several years past has been five per cent per annum. The maximum amount payable to the life tenant, under the new statute is three per cent. There is, therefore, a margin of safety of two per cent available in the average case in the final computation of allocation to income. Again, a property which would yield three per cent net per annum would, in all probability, produce a selling price sufficient to pay the life tenant, after final apportionment, a sum in excess of what had been paid within the statutory maximum during the period of salvage operation.

Many remedial rules of procedure or administration have created new rights not theretofore existing, which ultimately benefited one person as against another. The constitutionality of such legislation, even though it were retroactive in its application to existing actions or proceedings or to the estates of those dying before the statutory change was enacted, has been time and again sustained by the courts in the interest of uniformity and justice. As, for example, in Preston Co. *v.* Funkhouser (supra), our Court of Appeals and the United States Supreme Court upheld, as constitutional, a statute retroactive in scope providing that in any action for the enforcement of or based upon

breach of performance of a contract, interest shall be allowed upon the sum awarded, whether theretofore liquidated or unliquidated. In that case, the Court of Appeals, through Judge POUND, said: 'Every change in the remedies open to parties to a contract does not constitute an impairment of its obligation. Where the statute deals only with the remedy, the creation of a new and more adequate remedy does not impair the obligation of the contract. (Sackheim *v.* Pigueron, 215 N. Y. 62) * * * It follows that section 480 is a remedial statute to be construed, according to its literal meaning, to apply to all actions brought after it went into effect, irrespective of the time when the cause of action arose. It changes an existing right of action rather than creates a new right.' The court also pointed out that 'the mere fact that the statute is retroactive does not bring it in conflict with the Federal Constitution.'

It has always been the recognized function of the courts to promulgate rules of procedure and administration for the guidance of fiduciaries in their conduct of trust estates. Such rules have also found expression from time to time by enactment in the various statutes of our State. Examples of remedial statutes modifying or establishing rules of procedure in the administration of existing trusts, where their reasonableness and constitutionality have been sustained, are many. In Matter of Robertson *v.* de Brulatour (188 N. Y. 301), after the death of the testator, the Legislature established a new and different rule covering the compensation of trustees. An increased measure of compensation was provided. The trustees were held to be entitled to their benefit and commissions were allowed to them under the statute in effect at the date of the accounting. In Matter of Barker (230 N. Y. 364), commissions for receiving assets were allowed to the estates of deceased executors pursuant to a statute in effect at the date of the accounting but which was not enacted until subsequent to the death of the executors, and necessarily of the testator. In referring to the retroactive effect of the statute, the court there said: 'The general rule is that the fees of an executor are to be fixed by the rules and law which prevail at the time when they are settled. (Robertson *v.* de Brula-

tour, 188 N. Y. 301, 316, 317; Whitehead *v.* Draper, 132 App. Div. 799.) In the last case this principle was applied in the opinion written by Justice MC LAUGHLIN in a case where the statute invoked in aid of an executor's commissions was not passed until after his death. This is quite akin to the rule that remedies will be applied in accordance with the law which prevails at the time when relief is sought rather than at the time when the injury arose (Matter of Berkowitz *v.* Arbib & Houlberg, Inc., 230 N. Y. 261.)'

Other instances of remedial statutes may be found in (1) those modifying, after the death of the decedent, the classes of legal securities in which trustees are authorized to invest (City Bank Farmers Trust Co. *v.* Egans, 255 App. Div. 135; Matter of Hamersley, 152 Misc. 903; (2) the provisions of the Surrogate's Court Act (SS 225 and 226), providing that an administrator with the will annexed or a successor trustee may exercise powers granted to an executor or trustee to mortgage, lease or sell real property (Hollenbach *v.* Born, 238 N. Y. 34); (3) the sections of the Real Property Law authorizing the sale of real property where the interests are both possessory and future (Matter of Mersereau, 233 N. Y. 540; Matter of Gaffers, 254 App. Div. 448) and (4) the statute granting a creditor of an income beneficiary of a trust the right to require that ten per cent of the income be applied in satisfaction of his claim or debt. (Brearley School *v.* Ward, 201 N. Y. 358.) The constitutionality of each of these legislative enactments was sustained.

In Reiner *v.* Fidelity Union Trust Co. (126 N. J. Eq. 78; 8 A (2d) 175; revd. on other grounds, 127 N. J. Eq. 377; 13 A. (2d) 291) a statute giving the Court of Chancery of the State of New Jersey power to authorize or direct trustees to invest in securities other than those listed by the statutes as legal for trust investments was upheld as constitutional. The court there said: 'The statute does not purport to authorize the court to change substantive rights. It has reference merely to matters of administration.'

The extent to which courts have gone to sustain rules of procedure and administration is evidenced by the decision of the United States Supreme Court in Kuehner *v.* Irving

Trust Co. (299 U. S. 445). There, the constitutionality of clause (10) of subsection (b) of section 77B of the Bankruptcy Act (U. S. Code, tit. 11, S. 207), which limited the claim of a landlord for indemnity under a covenant in a lease in a corporate reorganization to an amount not to exceed three years' rent, was considered. Prior to the passage of this provision of the Bankruptcy Act, such claim was not provable or dischargeable in a bankruptcy proceeding. Under the new statute, the landlord's claim was allowed to the extent of three years' rent only. The rental value for the balance of the term of the lease under the rent fixed by the lease greatly exceeded the three years' rent allowed. It was asserted that this limitation offended the due process clause of the Fifth Amendment of the Constitution of the United States. The validity and constitutionality of the statute were sustained as giving a new and more certain remedy for a limited amount in lieu of an old remedy, insufficient and uncertain in its result. The statute was held to be fair and reasonable and to create uniformity of treatment of a peculiar class of claims, difficult of liquidation. It was held not to be the taking of the landlord's property without due process of law.

As applied to existing trusts, the above authorities clearly support the validity of the remedial legislation enacted in subdivision 2 of section 17-c of the Personal Property Law.

The rules under the subdivision are just, fair and reasonable. Only equitable adjustments and balances as between principal and income beneficiaries were declared to be effectuated by its provisions. It was within the province and power of the Legislature to enact them. The objection of the special guardian, therefore, addressed to the constitutionality of the statute is overruled.

Second. Such determination of constitutionality requires the surrogate to pass upon the various questions raised as to the effect of the terms of the new subdivision upon mortgage-salvage operations within its scope. These questions are stated and discussed seriatim as follows:

(a) Does the section apply to the salvage operation of property acquired by a trustee which was sold before April 13, 1940, the effective date of the statute, where the distri-

bution has not been closed by a decree upon a judicial settlement of the account or by a written or other valid agreement between the parties for a voluntary distribution?

The surrogate holds that where the salvage operation has been completed before the effective date of the new section, its terms do not in any way alter or change the rights of the parties. Once the salvage operation is finished before that date, there remains nothing to be done except to make the computation of apportionment and to distribute under the Chapal-Otis rules. The terms of the statute apply only to uncompleted salvage operations at the date of its enactment or to operations initiated subsequent to such date.

(b) As to operations uncompleted at the effective date of the new section, shall payments to the life beneficiary of net income, when earned, up to a maximum of three per cent per annum upon the face amount of the mortgage be computed upon an annual basis, or shall the entire period of operation, if extending over a period of more than one year, be considered in such computation?

The answer is obvious. The statute clearly contemplates that the net income payments shall be based upon the annual income of the property and not upon the income for the entire period of the unfinished operation. It provides (Pers. Prop. Law S. 17-c, subd. 2, Par. (a): 'Net income during the salvage operation up to three per centum per annum upon the principal amount of the mortgage shall be paid to the life tenant * * *' (Italics mine.) Annual rents and annual balancings of the account must thus be employed and the result of the *of the* operation of each parcel of property for each year must be treated as a separate entity in the computation and payment of the maximum net income permitted by the statute to be paid to the life beneficiary. It is an elementary rule in the administration of trusts that the computation of net income payable to a life tenant is based upon the yearly period, unless the terms of the will fix some other period. Any other policy would permit serious prejudice on the part of the trustee as against the life tenant by the withholding of accumulated income.

If, therefore, under this method of computation there are deficits of net income in lean years, they may not be made

up from surplus net income in productive years. Income earned in any one year in excess of the three per cent maximum payable to the life beneficiary and after repayment of principal advances, must be retained. Under the new section, principal advances 'shall be repaid out of excess net income above such three per centum per annum. When principal advances have been satisfied, any excess income shall be impounded * * * to await sale and apportionment'. If the payments of income to the life beneficiary were not based upon annual rents, and the deficiency of net income payments in lean years could be satisfied from excess income in good years, the provision of the statute that such excess income shall be impounded would be nullified.

(c) In the computation of the net income payable to the life beneficiary, shall the fiscal year beginning with the date of the acquisition of the real property be used or shall the calendar year be employed?

I hold that the anniversary date of the computations of the annual payments to the life beneficiary is the date of the acquisition of the real property and annual rents shall be based upon that date. The period of salvage begins from the date of acquisition of the mortgaged property. (Matter of Otis; supra). The net income payable to the life beneficiary must be computed upon rents received during the fiscal year beginning with that date. It is not based upon rents received during the calendar year. The explanatory note printed in the legislative bill states: 'The amendment provides for the immediate payment of income to the life tenant beginning with the date of the acquisition of the property by the trustee by foreclosure or conveyance in lieu of foreclosure.' The statute provides that net income shall be paid during the salvage operation. The annual accounts and the computation of the amount due the life tenant at the statutory rate up to three per cent per annum must be based upon the recurring periods of one year from the anniversary dates of acquisition.

(d) Where net rents up to a maximum of three per cent per annum have been paid to a life beneficiary during the period of salvage, has the new section changed the method of apportionment to be made after sale, as laid down by the

rules in Matter of Chapal (supra), and Matter of Otis (supra)? In other words, has the formula for the allocation, as between income and principal, been changed by the terms of the new section? The surrogate holds that no change was intended by the Legislature.

The new section merely makes mandatory the payments of three per cent of net income each year to a life beneficiary when earned. It does not, however, change the formula for ultimate apportionment of the net proceeds of the salvage operation between life beneficiary and remainderman. Again the new subdivision provides: 'The existing rules of procedure applying to salvage operations respecting existing mortgage investments are continued except as modified by the subparagraphs hereinafter set forth.' As stated in Matter of Chapal (supra): 'In such an investment situation what is involved is the salvage of a security. The security * * * is a security not for principal alone but for income as well.' Paragraph (a) of subdivision 2, with a view to protecting the interests of both life tenant and remainderman in such securities and to impartial and fair apportionment, provides as follows: 'The amount of all such payments shall be taken into account, however, in the apportionment of the proceeds of sale and shall be charged against the share of the life tenant.' All net income, therefore, including such as had been paid to the life beneficiary during the salvage period, must be added to the proceeds of sale of the property as the total salvage fund. Out of such total there shall first be deducted the amount required for repayment of principal advancements. The balance then remaining shall be apportioned according to the Chapal-Otis formula between income and principal. After the share due the life beneficiary has been computed upon such apportionment, there shall first be credited upon such share the net amount of rents paid to the life beneficiary during the salvage operation as an advancement to income. The amount so paid to the life beneficiary must be 'charged against the share of the life tenant' under the new section. The amount apportioned to income, less the income advanced to the life tenant, shall be the balance which the life tenant shall then be paid out of the proceeds of the salvage operation. This method of determining the ultimate shares allocable to income and principal unquestion-

ably, in my opinion, accords with proper accounting practice. (Matter of Chapal, supra; Matter of Otis, supra; Matter of Brainerd, (Wingate, S.) 169 Misc. 640, 644.)

Third. The questions presented for determination in this group do not arise out of the provisions of the new section. They involve problems that have not directly been passed upon by the Chapal-Otis cases or by other authorities.

(a) Where a trustee has taken over property under foreclosure or by deed in lieu of foreclosure and finds it in such condition as to require rehabilitation, are the expenses incurred to put the property in a tenantable condition exclusively capital charges to be treated as advancements from principal, or are they income charges?

The surrogate holds that where at the time of the acquisition of the real property, the premises were not in rentable condition the cost of putting them into such condition is payable out of principal. The cost of thereafter maintaining the premises in repair and in tenantable condition is payable out of income. Under the new paragraph (a) of subdivision 2, the 'cost of all capital improvements' is made a principal charge.

As applied to ordinary trust property where no salvage operation is in effect, the rule seems generally to be well settled that where real property is originally received by the trustee in an untenantable condition, the cost of rehabilitation is chargeable against principal. (Restatement of the Law of Trusts, comment i, S 233; Stevens v. Melcher, 152 N. Y. 551; Matter of Deckelmann, 84 Hun, 476; Matter of Suydam, 138 Misc. 873; Smith v. Keteltas, 62 App. Div. 174; Matter of Heroy, 102 Misc. 305.)

In the Restatement of the Law of Trusts the following appears: 'The cost of putting into tenantable repair premises which were not in such repair when received by the trustee, whether originally acquired by the trustee as part of the trust property at the time of the creation of the trust or subsequently acquired by him, is payable out of principal; but the cost of thereafter keeping the premises in repair is payable out of income.' The application of this rule to salvage operations would appear to be for the best interests of both life beneficiary and remainderman. Whenever necessary repairs or structural changes are made to

put real property in a rentable condition, there inures a benefit to both principal and income beneficiaries. The expenses of rehabilitation, therefore, which are incurred upon the acquisition of the property should be treated as advancements from principal and charged to principal. On the other hand, all expenditures for current repairs and those which are incidental to the management of the property, during the period of the salvage operation, should be charged to income under the general rule laid down in Matter of Albertson (113 N. Y. 434). The surrogate sustains the objections of the special guardian to the payment from principal of sums for the current repair and maintenance of the premises, other than the expenses of putting them into tenantable condition at the date of the acquisition of the property. If the parties are able to agree as to the items properly chargeable to income under this determination, a stipulation may be filed within ten days of this decision. If agreement is not reached, the matter will be set down for a further hearing upon this issue.

(b) The further question has been raised as to what is the method of apportioning dividends which may be received in payment, partially or in full, of claims arising out of the guaranty against loss resulting from a defaulted mortgage by an insolvent mortgage guaranty company. Certain sums have been received by the trustee in this estate on claims allowed by the Superintendent of Insurance, as liquidator of the Bond and Mortgage Guarantee Company. All of the properties involved were acquired by foreclosure or by deed in lieu of foreclosure prior to December 31, 1937. The order of liquidation was made and the rights of the parties under the Insurance Law are to be determined as of that date.

The obligation of the Bond and Mortgage Guarantee Company constituted a guaranty as to both interest and principal. The trustee filed proofs of claim with the Superintendent of Insurance. These claims covered the deficit of interest up to December 31, 1937, and the alleged liabilities of the guarantor for restitution of principal losses. In each case the default in interest was allowed by the Superintendent in full. The claims for principal charges were substantially reduced by him.

The surrogate holds that liquidating dividends when received must be treated as part of the general funds developed from the salvage operation. In this sense they are like rents received and the proceeds of sale of the acquired real property. The allocation made by the Superintendent of Insurance as between the guaranty of losses incurred in income and the guaranty of losses incurred in principal is to be treated as tentative only. In addition, all of the parties here conceded that because of the very large liabilities of the guaranty company, the dividends will be relatively small in amount. Moreover, the application of these liquidating dividends should be made as simple as possible.

With this objective in mind the surrogate holds that as to dividends received for income losses from the Superintendent of Insurance, such amounts should be added to the income (derived as rents) during the specific year of the actual receipt of the liquidating dividends. This addition to such rents may still leave a deficit in operation with no net rents available for the fiscal year. On the other hand, the addition may wipe out a deficit and produce a net income for such year. In the latter case the moneys become payable within the three per cent maximum to the life tenant. If there be any surplus above the three per cent maximum caused by the addition of these dividends, such surplus shall, under the rule of section 17-c, be applied on account of advances to principal, or if such advances have been satisfied, they shall be retained as part of the general funds of the salvage operation to await sale and final apportionment.

Any dividends received from the Superintendent of Insurance as tentative payments upon principal account shall likewise be retained as part of the general proceeds of the salvage operation to await final sale and apportionment, unless necessary to discharge unpaid balance of principal advancements.

Any dividends which may be received by the trustee on its claim under the guaranty of a mortgage subsequent to the completed salvage of such mortgage, should likewise be apportioned between principal and income in the same ratio

as has been applied to the proceeds of sale. They are additional proceeds of the salvage operation.

(c) Where the mortgage was originally guaranteed as to payment of interest and principal by a mortgage guaranty corporation and the guaranty has been canceled by the trustee, because of the insolvency of the corporation, shall the share of the life beneficiary be computed upon the rate fixed in the mortgage or at the rate agreed to be paid by the guaranteeing corporation? In other words, assume an original mortgage was made with six per cent interest. The corporation has reserved to itself, as the usual charge for the guaranty, one-half of one per cent per annum. The purchaser of the mortgage from the corporation became originally entitled to five and one-half per cent. Where the agency of the guarantor has been canceled, is the share of the life beneficiary to be computed for the duration of the period of salvage at six per cent per annum, the rate set forth in the instrument or at five and one-half per cent?

I hold that the rate of interest fixed in the mortgage taken over by the trustee from the guaranty company is the rate upon which the life beneficiary's interest must be computed. The Court of Appeals in Matter of Otis (supra) declared the rate of interest as fixed in the mortgage to be the rate to be used as a basis upon which allocation to income was to be made. It said: 'We prefer to adhere to our ruling in Meldon v. Devlin (167 N. Y. 573, affg. 31 App. Div. 146) that interest should be computed at the mortgage rate for the whole period.' Although the Court of Appeals in that case did not have before it the exact question here involved, its preference to the adoption of the rule which would fix the mortgage rate upon the cancellation of a guaranty, would appear to be clearly indicated. In view of the determination in Matter of Otis (supra), it is immaterial that only a yield of five and one-half per cent was guaranteed by the guaranty corporation.

Where, however, prior to acquisition by foreclosure or by deed in lieu of foreclosure, the trustee and the owner of the property have by agreement fixed a rate of interest below the rate prescribed in the mortgage instrument itself,

the reduced rate shall be used and not the mortgage rate. Such agreement for reduction of interest, if validly made, is binding upon the parties.

In the present proceeding, the trustee, by letter dated October 22, 1934, agreed to reduce the interest rate in the mortgage on one parcel of real property, 240 Floyd Street, Brooklyn, N. Y., from six per cent to four per cent. The interest of the life tenant in the salvage operation must, therefore, be computed at the latter rate from the date of such reduction to the date of sale.

(d) Further questions have been presented as follows:

Where there has been a resale of the foreclosed property and a purchase-money mortgage has been taken back, shall amortization payments under the new mortgage received by the trustee be applied primarily to the discharge of unpaid principal advances for the prior salvage operation, if any are still due? Where principal advances have been entirely repaid, shall amortization payments on the purchase-money mortgage be allocated between life tenant and remainderman as fixed upon apportionment of the proceeds of sale, pursuant to the applicable rules, upon the completion of the prior salvage operation?

The answer to each of these two questions must be in the affirmative. Since unpaid principal advances are a prior lien upon the proceeds of sale of the salvaged property (Matter of Chapal, supra; Matter of Otis, supra; Pers. Prop. Law, Sec. 17-c), principal has a prior interest in or lien upon the purchase-money mortgage taken back by the trustee upon the sale. In those circumstances, amortization payments made by the new mortgagor should be credited entirely to principal on account of such prior lien. When the principal advances have been entirely repaid, the amounts received for amortization should be apportioned between principal and income in accordance with the respective shares of each, previously computed and apportioned under the Chapal-Otis rule. The interest received by the trustee on the purchase-money mortgage I hold is payable to the life beneficiary. A similar conclusion was reached in Matter of Martin (165 Misc. 597).

(e) One further question requires disposition. It is claimed by the income beneficiary that she should be allowed interest at the prevailing rate upon the rents withheld from her by the trustee, which were distributable under section 17-c, from the date of their receipt by the trustee until their payment. The claim is disallowed. The surrogate holds she is entitled to no interest on such rents under the circumstances of this proceeding. In a case where the trustee arbitrarily refuses to pay, interest might be awarded against him for his recalcitrancy and by way of compensation for the detriment suffered by the life tenant.

The objections filed to the account herein are disposed of as follows:

Objections I, II, III, IV, V and VII filed by the special guardian are overruled. Objection VI, relating to the charging of expenditures for repairs, has been the subject of instructions and possible further hearing in the prior portion of this decision.

Objections 5 and 9 of the life beneficiary are overruled. The remaining objections filed by her are sustained to the extent of directing the necessary readjustments to be made in the account to comply with the conclusions of the surrogate contained in this decision.

Submit decree on notice settling the account in accordance with this decision and with the prior decision construing the will (175 Misc. 1042) made in this proceeding."

APPENDIX B.

Opinion of Court of Appeals, 289 N. Y. 423, in Matter of West.

In the Matter of the Estate of HENRY C. WEST, Deceased. WILLIAM J. DEMOREST, JR., et al., Appellants. CITY BANK FARMERS TRUST COMPANY, as Trustee, et al., Respondents.

Appeal by William J. Demorest, Jr., Ann Demorest and Carolyn Demorest, infants, and their special guardian, from an order of the Appellate Division of the Supreme Court in the first judicial department, entered April 16, 1942, which unanimously affirmed, so far as appealed from, a

decree of the New York County Surrogate's Court (Foley, J.) settling the accounts of City Bank Farmers Trust Company, as trustee under the will of Henry C. West, deceased, and construing the will of the testator. (See 175 Misc. 1042, 1044.) The appeal is from such order of the Appellate Division in so far as it sustains the constitutionality of subdivision 2 of section 17-c of the Personal Property Law (Cons. Laws, ch. 41).

Appeal by Emma M. West, by permission, from so much of such order of the Appellate Division as unanimously affirmed portions of the decree contained in articles 6, 7, 21, 22 and 26 thereof.

FINCH, J. The question presented for decision is the constitutionality and construction of the provisions of subdivision 2 of section 17-c of the Personal Property Law (L. 1940, ch. 452, effective April 13, 1940; Cons. Laws, ch. 41) in so far as the same modify retroactively the rules relating to mortgage salvage operations.

The new statutory rules allot to the life tenant out of the net income earned from the operation of real estate in salvage, an annual amount up to three per cent of the face value of the mortgage investment. Such right is granted in lieu of the discretion vested in the trustee under the heretofore existing rules of trust administration to pay net income or any portion thereof to the life tenant, a discretion which has not been exercised generally by trustees through fear of possible surcharge. Such payment of net income is made payable from the beginning of the salvage operation and is declared to be final and not subject to recoupment, either from the life tenant, or from the trustee or executor by way of surcharge. With the exception of the aforesaid modification, the previously existing rules governing salvage operations are continued except that annual net income in excess of the maximum sum payable to the life beneficiary, is directed to be held and further equitable adjustments upon the apportionment are also provided for, in order to insure to the remainderman that any unpaid advances from principal must be first repaid upon the final liquidation of the investment.

The validity of this statute has been put in issue upon this proceeding for an intermediate accounting by the trustee under the will of Henry C. West. By the terms of the testator's will, his residuary estate was devised to a trustee to apply the net income therefrom to the use of his wife during her life or until her remarriage. Upon the termination of the life estate, the trust was directed to be divided and continued upon certain shares for the benefit of a nephew and niece of the testator, with remainders over.

At the time of his death in 1934, the testator's residuary estate included, among various other assets, certain wholly owned guaranteed mortgages. Nine of these mortgages went into default after the death of the testator, and the estate acquired title to the real properties either by foreclosure or by deed in lieu of foreclosure prior to April 13, 1940; two of the properties were sold before that date, the income and proceeds therefrom, however, being retained in the hands of the trustee.

In the present proceeding the special guardian for the infant remaindermen contends, first, that the entire subdivision 2 of section 17-c is unconstitutional because it is expressly made retroactive in operation, and that, second, if constitutional, it does not apply, as a matter of construction, to the proceeds of the two properties which were sold before the statute became effective. The learned Surrogate sustained the constitutionality of the statute, but held as a matter of construction that it applied only to salvage operations uncompleted at the date of its enactment and hence was inapplicable to the two properties sold before it became effective. Upon appeal, the Appellate Division unanimously affirmed.

When a mortgage in default is foreclosed and title to the property is acquired by the trustee, the original mortgage investment is at an end and a salvage operation is initiated. (*Matter of Otis*, 276 N. Y. 101, 111, 112.) The real property thus acquired is substituted for the mortgage in the hands of the trustee and takes on the character of personality. (*Lockman* v. *Reilly*, 95 N. Y. 64, 71.) The trustee holds this real property so acquired and must administer it as an asset of the trust estate for the benefit of the life tenant and

the remaindermen. Like the mortgage, it is "security not for principal alone but for income as well." (*Matter of Chapal*, 269 N. Y. 464, 472.) With respect to the mortgages which the testator owned at the time of his death and with respect to any real property which might be acquired by the trustee following default in any of these mortgages, the testator as creator of the trust gave no express directions except the general direction of what is commonly understood by the use of the words "income" and "principal." After the initiation of the salvage operation, as before, both the life tenant and the remaindermen could compel the trustee to administer the trust and to apportion to each his just share of the income and principal, but not that of any particular asset of the trust. (*Lockman* v. *Reilly*, 95 N. Y. 64, 71; *Bennett* v. *Garlock*, 79 N. Y. 302, 320.) Although the rule requiring apportionment as between income and principal, of the proceeds of such sale has been long established (*Meldon* v. *Devlin*, 31 App. Div. 146; affd., 167 N. Y. 573), the rules relating specifically to mortgage salvage operations were speeded in the process of formulation by the courts with the coming of the economic depression of the 1930's. In *Matter of Chapal* (269 N. Y. 464) this court said: "We have another problem—that of the liquidation of real estate acquired of necessity because of default on a mortgage investment." Concerning these rules thus worked out to meet the emergency resulting from widespread foreclosures, in *Matter of Otis*, *supra*, at page 112, we said: "Both capital account and income account, as described in the *Chapal* case, are fictions * * *. If, then, the remaindermen are to participate in the apportionment on the feigned basis of unimpaired principal, the share of the life tenant should be computed on the same assumption. The invention of the 'original investment' is no more valid than the invention of 'unpaid interest' thereon. Indulgence in both fictions keeps the balance even between the respective parties in interest."

Moreover, we expressly said in the *Otis* case that the rules laid down were tentative only and not intended to be final. At page 115 it was said: "Perhaps it should be added that a general rule for such situations cannot be attained at

a bound, that no rule can be final for all cases and that any rule must in the end be shaped by considerations of business policy. Accordingly, we have here put aside inadequate legal analogies in the endeavor to express fair, convenient, practical guides that will be largely automatic in their application. Only the sure result of time will tell how far we have succeeded." It was also carefully pointed out that no hard and fast rule was laid down to guide the trustee in the disposition of net income earned during the salvage operation, but the disbursement of net income to the life beneficiary was left to the discretion of the trustee. In the *Otis* case we said at page 115: "* * * the trustee may distribute such surplus income in its discretion. (269 N. Y. at p. 470.) This discretion, moreover, should be exercised with appropriate regard for the fact that unless a life tenant gets cash he does not get anything in the here and now."

The Legislature has found, however, that trustees through fear of surcharge have accumulated surplus with the result that undue hardship has been visited upon life beneficiaries. Taking heed of this hardship at the request of the executive committee of the Surrogate's Association of the State of New York, the Legislature has declared its purposes in the statute itself. In part it reads: "The purpose of the enactment of this subdivision is declared to be the simplification of the rules of procedure in mortgage salvage operations and the elimination of present complications which work to the disadvantage of the life tenant * * * by depriving him of a fixed right to the actual payment of any net income earned by the property. Such fixed right is granted in lieu of the discretion now given to the trustee to pay net income or any part thereof to the life tenant. * * * Only equitable adjustments and balances as between the parties are intended to be effectuated by the provisions of this subdivision." Thus the Legislature has substituted in place of the discretion in the trustee permitting disbursement of surplus income, another more definite rule requiring some, albeit modest, payment of surplus income to the life beneficiaries. At the same time the Legislature has provided that additional income over and above the modest rate of payment shall be held until final adjustment, thus providing

for equitable adjustments and balances as between life beneficiaries and remaindermen upon final liquidation, and safeguarding, so far as reasonably possible, the rights of all interested parties. The statute provides: "Any payment of net income heretofore or hereafter made to the life tenant up to such three per centum per annum shall be final and shall not be subject to recoupment from the life tenant or as a surcharge against the trustee or executor. The amount of all such payments shall be taken into account, however, in the apportionment of the proceeds of sale and shall be charged against the share of the life tenant.

In thus formulating a rule that is final against recoupment for distribution of income received in excess of carrying charges, it does not appear that the Legislature has done more than direct a trustee to do what under the decisions of this court he has discretionary power to do. (*Matter of Otis, supra.*) Before the enactment of this statute, the life tenant could not have demanded as of right the payment to him during liquidation of more of the surplus income than he will receive under the statute. Neither does it appear that the remaindermen could properly have insisted that the trustee should be surcharged if in the exercise of his discretion he had paid to the life tenant the amount which the statute now directs. A statutory rule of administration which requires the trustee to apportion income in accordance with a fixed standard which in the exercise of administrative discretion the trustee would even without the statute have power to adopt does not, in our opinion, constitute a taking of property. The principle is applicable that "The mere fact that the statute is retroactive does not bring it in conflict with the Federal Constitution. * * * Nor has a person a vested interest in any rule of law entitling him to have the rule remain unaltered." (*Preston Co.* v. *Funkhouser*, 261 N. Y. 140, 144; *Munn* v. *Illinois*, 94 U. S. 113.)

As already noted, the rules of administration heretofore set forth were tentatively stated and expressly recognized as subject to change. Before a judicial declaration, thus tentatively stated, becomes a rule of property, it must have become permanently fixed and long continued. (*United*

States v. *Standard Oil*, 20 Fed. Supp. 427, 458; affd., 107 F. [2d] 402, cert. den. 309 U. S. 673.) In that case the court said: "However, before setting up a judicial declaration as a rule of property, we should require, at least, that it be fixed, long-continued, and relied upon by persons acquiring property, so that its repudiation would amount to a denial of due process." Nor can the statute in the case at bar be said to be arbitrary or capricious, but on the contrary, it is fair and reasonable and protects the interest of both income beneficiaries and remaindermen. As was said in *Thompson* v. *Siratt* (95 F. [2d] 214, 217): "To hold that subsection (n) is repugnant to the Fifth Amendment requires a finding that its provisions are arbitrary and unreasonable."

We have, therefore, in the case at bar, no taking of property, no contract right involved and no impairment of due process. This statute, therefore, cannot be held to be unconstitutional. (*Robertson* v. *deBrulatour*, 188 N. Y. 301; *Brearley School, Ltd.* v. *Ward*, 201 N. Y. 358.)

The sole remaining question is whether or not the statute is applicable in cases where the liquidation was complete before the date when the statute became effective, the income and proceeds of property being still undistributed in the hands of the trustee. We concur in the construction placed upon the statute by the learned Surrogate, namely, that its scope is limited to cases where liquidation of real property acquired is incomplete. This is in accord with the language of the statute which provides that net income "during the salvage operation" shall be paid to the life tenant. Even in a "pending proceeding" or "action for an accounting," the language of the statute confines its application to cases where liquidation is incomplete and where "during the salvage operation" a trustee has acted in accordance with the discretion at that time vested in him. The apportionment of the proceeds of the property, both income and principal, where liquidation was completed before the statute became effective must be determined in accordance with the rules heretofore formulated by the court.

The order should be affirmed, with costs to the respondent trustee and one bill of costs to the infant-appellants, William

J. Demorest, Jr., Ann Demorest and Charles Demorest, payable out of the fund.

LEWIS, J. (dissenting). The infant-appellants, by their special guardian, challenge the constitutionality of section 17-c, subdivision 2, of the Personal Property Law (Cons. Laws, ch. 41). The problem relates to the apportionment, between an income beneficiary and remaindermen, of income realized by a trustee from operations undertaken to salvage defaulted mortgages held by it as fiduciary. In this instance the mortgages in default were nine in number. The title to each mortgaged property came into the trustee either by foreclosure or by deed in lieu of foreclosure prior to April 13, 1940. Two of the properties were sold prior to that date, the avails of the sale being retained by the trustee.

The date last mentioned is important to our inquiry because it fixes the time when there became effective chapter 452 of the Laws of 1940 which added section 17-c to the Personal Property Law. It is the effect upon the rights of a life tenant and remaindermen of the retroactive provisions of subdivision 2 of that statute which has prompted the present challenge to its constitutionality.

Section 17-c of the Personal Property Law (added by L. 1940, ch. 452, effective April 13, 1940) provides rules for the administration of that portion of a trust fund in which is a real estate mortgage, held for the benefit of one or more tenants for life or a limited term with remainder over, where title to the mortgaged property has been acquired by the trustee by foreclosure or by conveyance in lieu of foreclosure. We are not here concerned with subdivision 1 of section 17-c which applies only to estates of persons dying, or trusts created, *after* its enactment and to mortgage investments made thereafter by a trustee of an existing trust. The challenge is to the constitutionality of subdivision 2 of section 17-c, the terms and rules of which "apply specifically (a) to the estates of persons dying *before* its enactment and (b) to mortgages on real property held by a trustee under a deed of trust or other instrument executed *before* the date of its enactment and (c) to real property acquired by foreclosure of mortgage or real property acquired in lieu of foreclosure *before* or after the date of its enactment in

trusts created or mortgage investments made prior thereto * * *." (Emphasis supplied.) In particular our inquiry goes to that portion of section 17-c to be found in subdivision 2(a) which in general provides that, regardless of advances made from the principal of a trust for the expense of a foreclosure, or of a conveyance of mortgaged property in lieu of foreclosure, and regardless of the cost of all capital improvements, payments—not subject to recoupment—shall be made to the life tenant from the net income during the salvage operation up to three per cent per annum computed upon the principal amount of the mortgage.

Clearly subdivision 2 of section 17-c is retroactive. By its terms it presumes to affect acts which occurred, and rights which accrued, prior to April 13, 1940—the effective date of the statute. Among acts thus affected was the execution on December 14, 1928, of the testamentary trust here involved; among rights thus affected are those of the life tenant and the remaindermen in the proceeds from transactions undertaken by the trustee as a means of salvaging mortgages which were a part of that trust—mortgages which, as we have said, were "security not for principal alone but for income as well." (*Matter of Chapel*, 269 N. Y. 464, 472.)

In the case last cited this court ruled that, upon a sale had in the course of a similar salvage operation (p. 472)—"* * * the proceeds should be used first to pay the expenses of the sale and the foreclosure costs and next to reimburse the capital account for any advances of capital for carrying charges not theretofore reimbursed out of income from the property. Then the balance is to be apportioned between principal and income in the proportion fixed by the respective amounts thereof represented by the net sale proceeds. In the capital account will be the original mortgage investment. In the income account will be unpaid interest accrued to the date of sale upon the original capital." (And see *Matter of Otis*, 276 N. Y. 101, 111; *Matter of McManus*, 282 N. Y. 420, 425.)

When the properties here involved came into the hands of the trustee, the rule of apportionment last quoted above was not a matter of grace, as the majority opinion herein

seems to hold. It was a rule of property the essential principle of which had long been recognized and applied in this jurisdiction and others, including England. (*Meldon* v. *Devlin*, 31 App. Div. 146; affd., 167 N. Y. 573 [1901]; *Parsons* v. *Winslow*, 16 Mass. 361, 365 [1820]; *Veazie* v. *Forsaith*, 76 Me. 172 [1884]; *Hagan* v. *Platt*, 48 N. J. Eq. 206, 207, 208 [1891]; *Greene* v. *Greene*, 19 R. I. 619, 621-624 [1896]; *Quinn* v. *First Nat. Bank*, 168 Tenn. 30 [1934]; *Matter of Nirdlinger*, 327 Penn. St. 171, 172, 173 [1937]; *Cox* v. *Cox*, L. R. 8 Eq. 343, 344, 345 [1869]; *Matter of Moore*, 54 L. J. Ch. 432 [1885], and see *Matter of Marshall*, 43 Misc. 238, 245 [1904].) A classical statement of the underlying principle which runs through the cases cited above was made in *Cox* v. *Cox*, *supra*, page 344, as follows: "The true principle *in all these cases is*, that neither the tenant for life nor the remainderman is to gain an advantage over the other—neither is to suffer more *damage* in proportion to *his estate and interest* than the other suffers—from the default of the obligor." (Emphasis supplied.) This was orthodox doctrine long before the decisions by this court in the *Meldon*, *Chapal* and *Otis* cases, *supra*.

In accord with that rule of property there had vested in the income beneficiary and the remaindermen respectively, prior to the effective date of section 17-c, subdivision 2, a proprietary interest in each of the properties acquired by the trustee. (*Matter of McManus*, *supra*, p. 426.)

Although the basis adopted by the courts for computing the item of interest involved differs in the various jurisdictions which have considered the question, there is a basic principle, as we have seen, which runs throughout the decisions cited above—*viz.*, that, in the income from salvage operations incidental to the administration of a trust estate, both life tenant and remainderman have a proprietary interest and both are entitled to be paid their proportionate shares thereof.

The comment made in *Matter of Rogers* (22 App. Div. 428; affd., 161 N. Y. 108), by Mr. Justice Cullen—later Chief Judge of this court—applies with equal force in the case at hand where the rights of remaindermen are at stake (p. 436)—"The equities of a life tenant to receive the whole

income that may accrue during his tenancy are every whit as great as that of the remaindermen to have the *corpus* of the trust preserved unimpaired. * * * *Why should each not have exactly his own, so far as it is possible to ascertain it?*" (Emphasis supplied.)

A marked difference should be noted between the provisions of section 17-c, subdivision 2, with which we are here concerned, and subdivision 1 of the same section. Unlike subdivision 2, the Legislature was careful in subdivision 1 to make its mandates in effect prospective—not retroactive. It also employed language by which its mandates would in no event conflict with any contrary intention which might be expressed by the creator of the trust.

The resultant effect of section 17-c, subdivision 2, is to transfer, without the right of recoupment, from the principal account of a trust to the income account, an amount—fixed arbitrarily and without regard to the demands of justice and equity in the circumstances at three per cent per annum computed upon the principal amount of each salvaged mortgage. Such a mandatory transfer to the life tenant of property rights which had become vested in the remaindermen under a rule of property which antedated the enactment of section 17-c, subdivision 2, transcends the Legislature's power. "Legislation which impairs the value of a vested estate is unconstitutional." (*Matter of Pell*, 171 N. Y. 48, 52, 53; *People* v. *O'Brien*, 111 N. Y. 1, 57-59; *Westervelt* v. *Gregg*, 12 N. Y. 202, 212.) As I view the statute it authorizes, without due process of law, the taking of property rights which became vested in the remaindermen under an established rule of property prior to the effective date of the statute. To that extent it violates the Fourteenth amendment to the Federal Constitution and article 1, section 6, of the Constitution of the State of New York.

I pass now to a phase of the problem which I think cannot be ignored. The questions of apportionment with which subdivision 2 of the statute attempts to deal are essentially judicial questions. This subject was examined by Story in his Equity Jurisprudence. ([2d ed.] vol. 1, § 489 *et seq.*) Stressing the "beneficial operations of courts of equity * * * upon this confessedly intricate subject," he said:

"Without some proceedings, in the nature of an account before a Master, there would be no suitable elements upon which any court of justice could dispose of the merits of such cases." In like vein it was said by Judge Loughran writing for this court in *Matter of Otis, supra* (p. 115), that "* * * a general rule for such situations cannot be attained at a bound, that *no rule can be final for all cases* and that any rule must in the end be shaped by considerations of business policy." (Emphasis supplied.) Subdivision 2 of the statute attempts to override all this by saying that *in every case* the life tenant must at all events immediately and finally receive net income at a rate arbitrarily fixed by the statute at three per cent—no matter what may be the cross-equities of the parties and without regard for the business risks of the particular salvage operation. To this extent, subdivision 2 of the statute makes it mandatory that the court shall adjudicate every "pending proceeding or action for an accounting" without affording the parties any opportunity to be heard. The draftsmen of the statute apparently recognized some difficulty on that score, for the statute says: "Only *equitable* adjustments and balances *as between the parties* are intended to be effectuated by the provisions of this subdivision" [2]. (Emphasis supplied.) We have, then, this extraordinary situation: While subdivision 2 of the statute has not changed the law that pending questions of apportionment are to be decided upon equitable principles, yet it declares that such principles must be applied by the courts, not according to the judicial judgment of what is equitable in the circumstances of a pending controversy, but according to a legislative mandate rigidly enjoined for all pending cases.

The Legislature has no power so to declare the law "for the information and government of the courts in the decision of causes before them." (Kent, Ch. J., in *Dash* v. *Van Kleeck*, 7 Johns. 477, 508, 509.) In this connection it should be observed that subdivision 2 of the statute is not emergency legislation; it invokes neither the general welfare nor any other consideration of public policy. In the only opinion written below, it is said: "The Legislature has done no more in formulating a modification of existing rules than

the courts themselves could do. * * *." (175 Misc. 1044, at p. 1050.) Such a proposition is not free from risk. Nobody knows what economic chaos may follow the present war. I am not prepared to say that as to all pending cases the Legislature may do at one stroke whatever courts of justice may do in accord with their tradition to proceed only in a particular controversy and only after taking evidence at a hearing held upon issues defined by pleadings. The Legislature can no more exercise judicial power than our courts can exercise legislative power. (See opinion by Ruffin, C. J. in *Hoke* v. *Henderson*, 25 Amer. Dec. p. 686 [N. C.].) The determination of rights of property *inter partes* is always a judicial question. As I view it, subdivision 2 of section 17-c of the Personal Property Law is a void attempt by the Legislature to make such a determination.

I am led by these considerations to dissent and vote for a modification of the Surrogate's decree accordingly.

Loughran, J. (dissenting). I add a few words to the dissenting opinion of Judge Lewis in which I concur entirely.

The crux of the prevailing opinion is this striking sentence: "A statutory rule of administration which requires the trustee to apportion income in accordance with a fixed standard which in the exercise of administrative discretion the trustee would even without the statute have power to adopt does not, in our opinion, constitute a taking of property." I cannot assent to so free an appraisal of the retroactive mandate of the Legislature.

No authority is cited to show that it was always open to trustees of their own motion to pay net income to a life tenant at such a "fixed standard," in peremptory disregard of the recoupment rights of remaindermen. Indeed the general understanding of the profession appears to have been the other way, seeing that the Surrogates who devised the statute have vouchsafed us one reason alone for its enactment, *viz.*, "Trustees have hesitated to pay such net income because in the case of overpayment to the life tenant, the trustee might be surcharged with that amount." (See L. 1940, p. 1182.)

This recognition by trustees of the conflicting rights of remaindermen was not without justification. It is true that

hitherto a trustee for a life tenant and remaindermen was entitled to distribute surplus income in his discretion. (*Matter of Otis*, 276 N. Y. 101, 115.) But that discretion was always to be exercised by a trustee with reasonable judgment and with an even hand between the life tenant and the remaindermen in the particular circumstances. (See *Carrier* v. *Carrier*, 226 N. Y. 114, 125, 126; 28 Halsbury's Laws of England [1st ed.] 123, 124; 2 Scott on The Law of Trusts, § 187; 4 Pomeroy on Equity Jurisprudence, [5th Ed.] § 1062a.) The retroactive provisions of the statute direct trustees instanter to make final payment of net income to a life tenant not at a fixed rate merely, but at the expense of the remaindermen if need be. Hence I cannot accept the presupposition that the statute confers no new power upon trustees.

There is no occasion now for examination of the real nature of the equitable right of a trust beneficiary. At least the beneficiary owns the obligation of the trustee—a thing which is as truly the subject-matter of property as any physical object. (See Ames, Lectures on Legal History, p. 262. Cf. 1 Scott on The Law of Trusts, § 130.) Consequently I see no warrant for the view that the respective interests of beneficiaries of a discretionary trust are not rights of property in the constitutional sense. (See *Pritchard* v. *Norton*, 106 U. S. 124, 132.)

LEHMAN, Ch. J., RIPPEY, CONWAY and DESMOND, JJ., concur with FINCH, J.; LEWIS and LOUGHRAN, JJ., dissent in separate opinions in which both concur.

Order affirmed, etc.